PacificCPE

COURSE
40656A

Beneficiary Designations and Cross-Border Estate Issues

Naming the wrong beneficiary on a retirement account or life insurance policy can undo even the most carefully drafted estate plan. This course covers how to evaluate and coordinate beneficiary designations across retirement plans and insurance products, then addresses the added complexity of estate planning when clients have assets or family members in multiple countries. Professionals advising clients with international ties or significant retirement assets will find practical, actionable guidance throughout this course.

CREDIT HOURS 2 | FIELD OF STUDY BUSINESS | EXAM QUESTIONS 10

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LEARNING ASSIGNMENTS AND OBJECTIVES

Assignment

- Study the full course materials included here.
- Complete the review questions after each chapter.
- Answer 10 final exam questions.
- Final exam is scored immediately, 70% or better passes.
- Certificate of completion is available in your account.
- Failed exams can be retaken free of charge.

Course Objectives

- Recall who qualifies as an "eligible designated beneficiary" according to the IRS.
- Recall how the IRS determines whether an individual is domiciled in the United States.

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Chapter 1: NAMING THE RIGHT BENEFICIARIES: RETIREMENT AND LIFE INSURANCE

Chapter Objective

After completing this chapter, you should be able to:

- Recall who qualifies as an "eligible designated beneficiary" according to the IRS.

Retirement accounts offer tax incentives to help you squirrel away some of your paycheck for retirement. When Congress came up with these tax breaks, legislators really weren't thinking of retirement accounts as a way to pass money along to heirs. The idea was that you were supposed to save the money during your working life to spend during your retirement years, leaving nothing behind. Personally, I think that's an excellent plan. But it doesn't always work out that way: Many people work to an older age these days, so they don't spend down their retirement as they had planned. Some people find that their other investments have done so well that they don't need to take more than the minimum required distributions required by their IRAs or 401(k)s. I worked with many clients who had saved aggressively during their working years only to find out that they had more retirement assets than they thought that they'd ever need.

After all, every dollar they withdraw from these plans is subject to income tax, while their investment dollars are taxed only for income, not upon withdrawal. As a result, retirement assets are sometimes a large part of the inheritance a person leaves behind.

The way in which people inherit retirement assets changed fundamentally in December 2019, when Congress passed the SECURE Act, and in December 2022, when Congress passed the SECURE Act 2.0 (SECURE stands for Setting Every Community Up for Retirement Enhancement—I knew you'd want to know this). The big picture is that the SECURE Acts now require that almost everyone other than surviving spouses take the money out within 10 years and pay the required taxes on those withdrawals. Furthermore, during those 10 years, these beneficiaries are also required to withdraw a required minimum distribution based on their age. As a result, the tax benefit that used to come with inheriting retirement assets, tax-deferred savings, is mostly gone (beneficiaries who waited until their own retirement, when their tax brackets were lower than when they were working, enjoyed the benefit of lower taxes when they tapped into those accounts). Remember the part above where I said that Congress didn't really set up retirement accounts with estate planning in mind? Well, the SECURE Acts take us back to those intentions—now, the people who saved the money get the benefit of tax deferral, but most of the people who inherit what's left do not.

Life insurance, too, is often a large part of what people leave behind to their loved ones. But my clients often forgot to mention it when we are making a list of their assets, because to them it's not "real" money. And, like retirement assets, life insurance passes only to those named as beneficiaries, not by the terms of a will or trust. In this chapter, I want to make sure that you understand how to include both kinds of assets in your overall plan. And I want to impress upon you the need to take the time to make sure you've named the right beneficiaries for both your retirement plans and life insurance policies.

Life insurance provides ready cash when it might be most needed. It can help pay down a mortgage or send children to college. Life insurance can play a complicated role in an estate plan, but for our purposes, having enough and naming the right beneficiaries are the key issues.

Retirement accounts are important parts of an estate plan. I'll explain more as this chapter goes on, but for now, here's why:

- **Recipients will pay tax.** Unlike the other assets you'll be leaving to your loved ones, most retirement plan money is going to be subject to income tax when the money is withdrawn. You'll want to take that tax into consideration when balancing the value of the gifts you are giving to each recipient.
- **Recipients will get more if they don't withdraw funds right away, although most have to take the funds out within 10 years.** Because inherited retirement assets are the only assets subject to income tax, this is the last money you want your beneficiaries spending right away—unless, of course, they need it. Although most beneficiaries are required to withdraw the entire amount in an inherited IRA within 10 years, early withdrawals still mean that the assets, now out of the account, aren't growing on a tax-deferred basis. When retirement assets are a large part of your plan, educating your beneficiaries about how to manage them wisely should be part of that plan, too, especially because many people will inherit their parents' retirement assets during their own peak earning years and highest income tax rates.
- **Keep those assets out of probate!** Last but not least, as long as you handle your retirement accounts properly, these assets will be distributed after your death without going through probate.

Many books have been written on retirement plans. Many of them are huge or difficult to read—often both. Just the rules for taking money out of retirement plans (let alone the best way to put money into them) are complicated, and they change often.

But for now, here's all that matters: Someday, hopefully far in the future, your family, friends, or favorite nonprofit will inherit your retirement assets. So, in this chapter, I want to focus on what you should do now to make the process as easy as possible for those who inherit your retirement accounts. Common steps include making sure that your retirement plans have the right

beneficiaries, converting old 401(k) s to IRAs, considering a Roth conversion if you qualify, and understanding how your retirement assets fit into your estate plan.

Because we'll be talking about beneficiary designations, I'm also discussing life insurance and how best to make sure that your policies support your estate plan. The main idea is that you want your estate plan to be coordinated with your retirement plans and life insurance policies, to help your beneficiaries keep the money in your retirement accounts growing tax free as long as possible. I'll also explain how to use your retirement accounts and life insurance policies to benefit charity.

ALPHABET SOUP: RETIREMENT PLANS EXPLAINED

Broadly speaking, there are three types of retirement plans that most people use to save for retirement: traditional IRAs, 401(k) plans (or 403(b)s if you work for a nonprofit or school), and Roth IRAs. All three offer significant tax incentives to encourage you to save money now so you'll have it to spend when you retire. Some employers also offer new forms of Roth plans (Roth 401(k)s and Roth 403(b)s). You might have more than one of each retirement plan on your list, especially if you've changed jobs a few times. Old retirement plans have a way of piling up if you're not careful (more on that later).

Tip

Get 'em together. A good way to keep track of all of your retirement accounts is to put each statement in a binder, one section per plan. That way, all of the relevant information is in one place. Also, if you get tired of filing so many different statements, that might nudge you to consolidate them into only one or two accounts.

Traditional IRAs

IRA stands for Individual Retirement Account. You can set up an IRA yourself to save and invest your earnings over your lifetime. At tax time, you can deduct from your gross income the amount you contribute, up to a certain amount each year ($7,500 is the maximum for 2026, or $8,600 for persons over age 50), as long as you are not also covered by your employer's retirement plan.

Example

Phil, who is 55 years old, contributes the maximum, $8,600, to his IRA. He is not covered by an employer's plan. He is able to deduct all $8,600 from his income.

When you withdraw your money from an IRA (your contributions plus the growth over time), it is subject to income tax. But by then you'll likely be retired, and your income tax rate will probably be

lower than it is now. You may begin withdrawing money from traditional IRA plans when you are 59½ years old.

If you withdraw the money early, you will generally be subject to penalties for early withdrawal, and then you'll pay income tax on top of that. You *must* begin to take money out when you turn 73 years old. By 2033, the age will be 75.

Before the SECURE Act, you couldn't continue to contribute to your IRA after the required distribution age—then 70½—but now you can contribute as long as you are still working. There are several kinds of IRA plans, but they are all variations on this theme.

401(k) Plans

Your employer usually sets these up and offers several investment choices. (If you are self-employed and have no employees, you can set up a solo 401(k).) Both employees and those self-employed contribute pretax money, deducted from their paychecks. That way, your taxable income is reduced by the amount you contribute. Some employers even contribute matching funds. The money grows tax free in the account.

As with IRAs, you may begin withdrawing money from your 401(k) plan when you are 59½ years old, unless you are still working, your retirement plan is sponsored by your employer, and the employer does not require that you take required minimum distributions. Early withdrawals are also generally subject to penalties. When you withdraw money, it is subject to income tax.

403(b) Plans

If you've worked for a school or a nonprofit, you'll have a 403(b) plan. These are very similar to 401(k) plans except that they are governed by a different section of the federal tax law.

Roth IRAs

Roth IRAs are like traditional IRAs turned upside down. Like traditional IRAs, you can set these up yourself, but you make contributions with money you've *already paid tax on*. There's no mandatory withdrawal age, and you won't enjoy a tax deduction for the contributions you make. So what's so great about Roth IRAs? *When you withdraw money from a Roth IRA, you don't pay tax on any of it, including the growth*. You endured the tax hit when you earned the money during the years that you contributed to the Roth IRA, but all of the growth of the funds is tax free, as long as you've had the account for more than five years.

If you can afford to create a Roth IRA and you qualify to do so, it can be a terrific way to pass money along to your loved ones. For people with large estates, converting a traditional IRA to a Roth IRA has two other benefits: First, as noted above, Roth IRAs do not have required minimum distributions, so if you don't need to withdraw the money, you don't have to. Second, when you

convert a traditional IRA to a Roth IRA, the taxes you pay at the time of conversion reduce your estate—in effect, you are prepaying a tax for your heirs.

For 2026, Roth IRAs are available to married couples filing jointly with an adjusted gross income of less than $252,000, and to individuals filing returns with an adjusted gross income of $168,000 or less. These income limitations are set by the IRS and are indexed for inflation.

Roth 401(k)s and Roth 403(b)s

The newest options in the retirement planning world are the Roth 401(k) and Roth 403(b) plans. If your employer offers one (not all do), you can sock away a chunk of your salary and let it grow tax free. Like a Roth IRA, you'll put money into the plan that you've already paid tax on, but future distributions will be tax free. There are no income restrictions on who can participate.

> **Current Beneficiaries List I. Retirement Assets: Current Beneficiaries Retirement Plan Owner Beneficiaries Vanguard Roth IRA, Hannah Primary: Doris Number 123456**
>
> Secondary: Josh (age 21), Chris (age 25) TIAA-CREF 401(k) Doris Primary: Hannah Secondary: Josh and Chris Primary: Secondary:
>
> **II. Life Insurance: Current** Beneficiaries **Life Insurance Policy** Owner Beneficiaries West Coast Insurance Hannah Primary: Doris Company
>
> Secondary: Josh and Chris Planters Beneficial Life Doris Primary: Hannah Secondary: Josh and Chris Primary: Secondary:
>
> **III. Any Other Payable-on-Death Accounts** Account Owner Beneficiaries Savings Account Hannah Primary: Doris #1234-6789-123
>
> Secondary: Josh and Chris Primary: Secondary: Primary: Secondary:

WHAT BENEFICIARIES HAVE YOU ALREADY NAMED?

A million books and websites can help you figure out whether you're invested in the right plan for yourself and your family and have saved enough for your retirement (I include some of the best retirement resources later in this chapter). But that's not the focus of our discussion. For estate planning purposes, the important thing is to understand who will get the money from your retirement accounts if you die before withdrawing it all.

First things first: You need to know what kind of retirement plans you've got at the moment and who will inherit them. I include a Family Inventory form with this course (see Chapter 2 of course 40651B), which includes a section for you to list your retirement accounts and life insurance policies.

I also include a Current Beneficiaries List so that you can list the beneficiaries of your retirement plans, life insurance policies, and other beneficiary-designated plans (see the sample above).

Form

Current Beneficiaries List. A blank copy of this worksheet and the other forms in this book can be located in the appendix.

If you don't remember whom you named on your retirement plans, it's time to find out. Some companies let you view your beneficiary designations online; others require a phone call to either your HR department or the plan administrator (for example, Vanguard or Fidelity).

If you don't remember whom you've named, don't panic. My clients often couldn't remember whom they'd named, or even what plans they had. We are all busy, and sometimes these plans, especially those from long ago, are easily overlooked and forgotten. The good news (the really good news) is that now is the perfect time to figure this out.

Each retirement plan asks you to name at least one beneficiary who would inherit the assets in the plan if you were to die with a remaining balance. You named this person when you filled out the form to create an IRA or enrolled in your employer's 401(k) or 403(b) plan. If you also own an annuity, that will have a beneficiary as well.

Your primary beneficiary is your first choice to inherit the money in the retirement plan. If that person dies before you do, your secondary beneficiaries, sometimes called the "contingent" or "alternate" beneficiaries, will inherit the money.

If you're married, you'll likely name your spouse as your primary beneficiary and your children (if any) as the secondary beneficiaries. Unless you have a child with special needs or a beneficiary that requires a trustee to manage retirement assets over time, you wouldn't usually name your living trust. Assets held in living trusts are subject to higher income tax rates than nearly all individuals, so you'd only name a trust when the need for supervision requires the additional cost in income taxation.

If you're not married, you can name a partner, your friends or relatives, or charities. If you are charitably inclined, naming charities as your beneficiaries is a great idea. Charities don't pay tax on these withdrawals, so they will receive 100% of the value. In contrast, if you name a person, like your brother, he will pay income tax on what he withdraws. If you do name a charity as a beneficiary of a retirement plan, make sure to tell them! Otherwise they'll have no way of knowing that you've left the assets to them—beneficiary designations are not public documents.

Example

Dem names her local women's shelter as the beneficiary of her IRA. When she dies, the shelter withdraws the balance of $100,000 and uses it to build a new preschool for children staying at the shelter. If Dem had named her brother, Jed, as the beneficiary, he would have withdrawn that $100,000, and paid 24% of that in income tax, leaving him with the balance of $76,000.

Because your will or a trust won't control how your retirement assets are distributed, you should make sure that your beneficiary designations are correct and current. If you've been divorced or married since you opened up a plan, or had children since then, chances are you've listed outdated or incorrect beneficiaries. It's a good idea to double-check what beneficiaries you've designated even if no major life changes have happened. You might have a new idea of whom you want to benefit.

If you need to change your beneficiary designations, don't worry—it's a piece of cake. I'll discuss it at the end of this chapter.

Obviously, you don't want to leave retirement plan assets to the flat-out wrong person. That would be a careless mistake. But even if you simply want to leave these assets to your spouse, child, or other loved ones, as most people do, it's worth understanding the best way to do so. Retirement plans have tricky rules about how money must be withdrawn and when. Worse, the rules are different for different beneficiaries.

RETIREMENT 101: THE BASIC RULES OF CHOOSING BENEFICIARIES AND WITHDRAWING MONEY

It is critical to make sure that you have named the right beneficiaries to inherit any money you might leave behind in your retirement plans. Simple, eh? Well, for most people, it is.

But always keep the big picture in mind. First, if you have a will or a trust, ask yourself if the plan and your beneficiary designations match. Having a different set of instructions means that your plan won't work as you intended it to work.

Example 1

Ronald's living trust leaves all of his assets to his partner, Jim. But Ronald's IRA names Martha, Ronald's sister, as his beneficiary. Ronald opened that plan in 2000, years before he met Jim. Ronald's estate planner asked Ronald to check on his beneficiary designations. Ronald had forgotten that he'd named Martha as beneficiary of his IRA.